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Docket Control  
Chairman Robert (Bob) Burns  
Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, AZ 85007

RE: Response of Arizona Public Service Company (APS or Company)  
Application for Approval of Rates, Charges and Schedules  
Docket No. E-01345A-19-0236

Dear Chairman Burns:

APS appreciates the opportunity to respond to your letters, as well as questions from other stakeholders regarding the use of accelerated depreciation and securitization to facilitate a lower cost transition to a clean energy future. The options outlined in your letter cover many important operational, customer cost, and financial considerations.

### **Introduction**

Based upon our analysis, APS believes that securitization, if structured properly, can benefit both APS and its customers, particularly if coupled with other financial tools, such as the Advanced Energy Mechanism proposed in APS's rebuttal testimony.

While securitization may be an important tool, it is not currently an option in Arizona and would require Arizona legislation to become viable. In addition, even if securitization eventually becomes a possibility for Arizona utilities, there are still a number of significant obstacles to any early shutdown of Four Corners.

- A 2023 shutdown is not realistic since APS would be unable to procure and assure reliable replacement power in this timeframe as discussed in Brad Albert's rebuttal testimony. Accordingly, this analysis did not quantify the customer impacts associated with a 2023 shutdown of the Four Corners and Cholla plants.
- Four Corners is a co-owned facility; all of the owners would need to agree to cease operations. It's important to note that operations at the plant, including any decision to cease operations early, are governed by numerous commercial contracts, including a coal supply agreement with the Navajo Transitional Energy Company (NTEC).

- Public Service Company of New Mexico (PNM) recently announced plans to sell their share of the plant to NTEC in 2025 bringing NTEC's share of the plant to 20 percent. In the proposed agreement, PNM commits to assuring continued normal plant operations between now and 2025 and has agreed that it will not vote to shut down the plant in that timeframe.
- APS has announced its plan to exit Four Corners by 2031. Since the plant is a major source of revenue for the Navajo Nation, an even earlier retirement of the plant would have a significant impact on the Navajo Nation and its citizens due to the loss of revenues.

### **Summary of Results**

APS retained the consulting firm Energy and Environmental Economics (E3) to assist with the analysis requested in your letters to assess the customer impact of two cost recovery methods: accelerated depreciation or securitization of the unrecovered costs associated with an early closure of the Four Corners plant.<sup>1</sup> Our assessment assumes that in the accelerated depreciation scenarios, depreciation brings the plant's net book value to zero in the assumed retirement year. In contrast, under securitization, the securitization treatment securitizes the plant's unrecovered costs in the assumed retirement year. In evaluating the requested cases, APS assumes concurrent cost recovery for replacement generation.

In summary, securitization appears to be a more useful tool than accelerated depreciation to facilitate a clean energy transition for the following reasons:

- Accelerated depreciation of Four Corners for the remainder of its operating life would put additional upward pressure on customer rates and affordability, and therefore does not appear to be the preferred policy tool for fleet transformation to clean energy. When the compressed depreciation schedules are coupled with the cost of new investments in clean replacement resources, there is further upward pressure on customer rates.
- While securitization can be effective in reducing costs during a transition period, the earlier the plant retirement, the greater the reliability challenge to put clean replacement capacity in place in a timely fashion – a critical requirement given Arizona's energy needs and the regional reliability challenges of this past summer.

### **Analysis Performed**

Our analysis covered the six requested cases for accelerated depreciation and securitization (including sensitivities on the bond rate). As previously noted, and as described further in Brad Albert's testimony as a response to intervenors' recommendations, a 2023 shutdown is not possible given that the timeframe does not allow adequate time to procure and assure replacement resources required to maintain reliable operations, and therefore has not been modeled.

Each scenario was modeled over an 18-year period (2021-2038), for the 2026, 2029, and 2031 retirement dates and each securitization scenario assume a 20-year bond as a simplifying assumption, which could produce a greater opportunity for customer savings as compared to shorter bond terms. The analysis is illustrative only and does not presume feasibility of early retirement as discussed in the introduction. A decision regarding early

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<sup>1</sup> See August 11 and September 1, 2020 Letters from Chairman Burns in Docket No. E-01345A-19-0236.



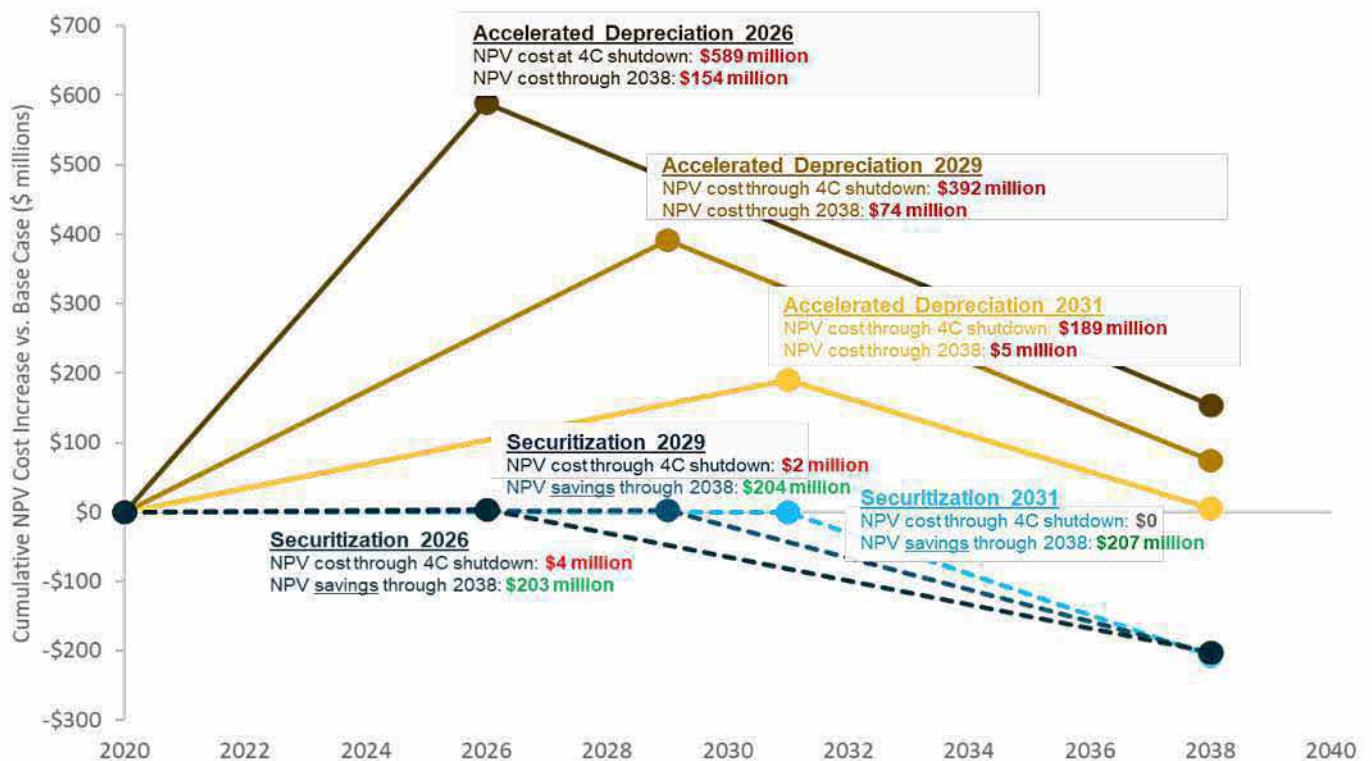
retirement would necessarily require appropriate consideration of operational, reliability and community needs. The actual operational and planning challenges associated with accelerated retirement are discussed in the rebuttal testimony of APS witness Brad Albert, also filed today.

In order to ensure an appropriate matching of securitization capital with replacement resource requirements, APS has included the cost of replacement resources in each case and assume concurrent cost recovery as previously noted. Each case calculates the difference in net present value of revenue requirement compared to a Base Case that assumes regulatory asset treatment of the plant's unrecovered costs after its retirement in 2031.

While securitization alone can provide cost savings, it is essential to also include the estimated cost of the necessary replacement generation. For modeling purposes, a generic clean energy replacement resource portfolio, consistent with the "Accelerate" case from the APS 2020 IRP is assumed. This portfolio includes a plausible mix of stand-alone battery storage, solar plus storage facilities, and wind to match the capacity and energy of Four Corners in each post-retirement year.

**Figure 1** below summarizes the analysis and cost impacts of accelerated depreciation and securitization on Four Corners shutdown years of 2026, 2029, and 2031, based upon the midpoint of the range of interest and replacement generation cost assumptions. Numbers are in millions of dollars over an 18-year period and shown as differences in revenue requirement from a Base Case (e.g. the APS-filed "Accelerate" case from the 2020 IRP).

**Figure 1: Summary of Net Present Value Revenue Requirement Results**



This graph shows cumulative NPV cost (savings) at two points in time for variations of accelerated depreciation and securitization: (1) through the year of Four Corners shutdown, and (2) through 2038. Point estimates are based on midpoints of ranges examined in analysis.

The graph illustrates two key findings: 1) accelerated depreciation would increase customer costs for a transition from coal to clean generation, regardless of retirement date; and 2) the modeling demonstrates potential savings in all securitization scenarios. Critical operational and reliability considerations associated with an early shutdown are not reflected here and must be considered to determine the appropriate path forward.

### **Analysis Conclusions**

The analysis demonstrates that securitization can reduce customers costs compared to accelerated depreciation. However, in the goal to achieve a reliable and affordable transition to a cleaner energy future, securitization works best when paired with other financial tools, such as contemporaneous recovery, which is assumed in our analysis.

In conclusion, securitization, when coupled with an efficient method to recycle capital expenditures by investing in clean energy and a recovery mechanism such as the Advanced Energy Mechanisms, is in the best interest of both the Company and the customer, producing savings and supporting affordability in the transition to a 100% clean energy future.

APS thanks Chairman Burns for allowing APS sufficient time to thoughtfully analyze these issues and looks forward to discussing them further in its pending rate case.

Sincerely,

/s/ Kristie Cocco

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